
ARTHUR
ANDERSEN
& CO.

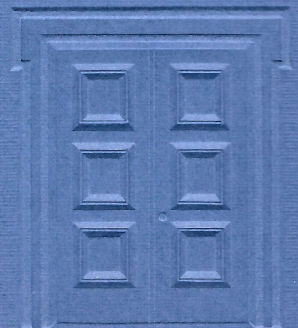
COMMODORE BUSINESS MACHINES, INC.

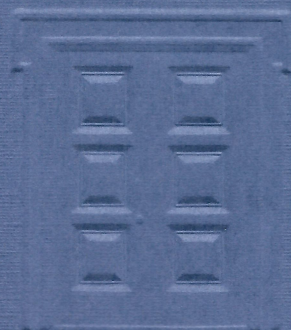
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MEMORANDUM ON ACCOUNTING PROCEDURES

AND INTERNAL CONTROL

JUNE 30, 1984







COMMODORE BUSINESS MACHINES, INC.

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MEMORANDUM ON ACCOUNTING PROCEDURES

AND INTERNAL CONTROL

JUNE 30, 1984

ARTHUR ANDERSEN & CO.

FIVE PENN CENTER PLAZA
PHILADELPHIA, PENNSYLVANIA 19103
(215) 241-7300

December 10, 1984

Board of Directors
Commodore International Limited
1200 Wilson Drive
West Chester, Pennsylvania 19380

Gentlemen:

The accompanying memorandum includes suggestions for improvement of accounting procedures and internal accounting control measures that came to our attention as a result of our examination of the consolidated financial statements of Commodore Business Machines, Inc. and subsidiaries for the year ended June 30, 1984. The matters discussed herein were considered by us during our examination, and they do not modify the opinion expressed in our auditors' report dated August 3, 1984 on such financial statements.

In accordance with generally accepted auditing standards, we performed a study and evaluation of existing internal accounting controls for the purpose of providing a basis for reliance thereon in determining the nature, timing and extent of the audit tests applied in connection with our examination of the Company's 1984 financial statements. While certain matters that came to our attention during the study are presented in the accompanying memorandum for the consideration of management, the study was not designed for the purpose of making detailed recommendations and would not necessarily disclose all weaknesses in the existing system.

The accompanying memorandum also includes comments and suggestions with respect to other financial, and administrative matters that came to our attention during the course of our examination of the financial statements. These matters are offered as constructive suggestions for the consideration of management as part of the ongoing process of modifying and improving accounting control and other financial and administrative practices and procedures.

Very truly yours,

Arthur Andersen & Co.

COMMODORE BUSINESS MACHINES, INC.

PREFACE

This memorandum covers both the Systems Division and the Semiconductor Division.

The comments and suggestions have been grouped by division and by cycle. Cycles include the following:

- . Financial Reporting - General ledger posting, journal entry preparation, consolidation, record control, etc.
- . Revenue - Credit granting, order entry, delivery and shipping, billing, accounts receivable, cash receipts, etc.
- . Conversion - Cost accounting, manufacturing control, inventory management, property accounting, etc.
- . Treasury - Cash management, interest, debt management, equity transactions, etc.
- . Purchasing - Purchasing, vendor selection, receiving, cash disbursement, account distributions, prepayments/accruals, etc.
- . Payroll - Payroll accounting and disbursement, labor, attendance reporting, etc.

COMMODORE BUSINESS MACHINES, INC.

MEMORANDUM ON ACCOUNTING PROCEDURES AND INTERNAL CONTROL

SYSTEMS DIVISION

- . The Internal Auditors should perform a review of the Data Processing Department on a regular basis.
- . The Company should adopt a more comprehensive disaster recovery plan for its data processing facilities.
- * . Password controls over data processing should be enforced and changed periodically.
- . An "in-house" user support group could be established to improve documentation and communication of internally developed Commodore microcomputer applications.
- . A formal policy should be developed and maintained regarding the acceptance of returns under "Blanket" Return Authorizations.
- . Returned inventory should be matched with the original sales invoice.
- * . The co-op and market development fund accruals should be based upon actual allowances given.
- . The co-op detail should be reviewed for accuracy and approval of overpayments by management personnel.
- . The Company should continue to improve its timely reconciliations of high volume/past due accounts.
- . Causes of book-to-physical adjustments should be identified on a timely basis.
- . The Company should continue to improve its controls over in-house inventory transfers.

Comments and suggestions identified with an asterisk (*) are those that were made in the prior year's memorandum and are repeated since similar situations existed during our recent examination, although possibly to a different degree. Also, during fiscal 1984, the Company implemented most of the prior-year recommendations and these are not included in the current-year report.

COMMODORE BUSINESS MACHINES, INC.

MEMORANDUM ON ACCOUNTING PROCEDURES AND INTERNAL CONTROL

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- . Proper cash management/control procedures should be adopted and enforced.
- . The Company should develop, distribute and maintain a formal policies and procedures manual for expenditures and payroll processing.
- . Long-outstanding payable items should be evaluated on a timely basis, and debit balances, when material, should be reclassified to receivables and stated at net realizable value.
- . A control log of payroll check numbers should be maintained and compared against checks prepared.
- . All unclaimed payroll checks should be forwarded to the Internal Audit Department for adequate disposition.
- . A summary of payroll registers should be maintained and regularly reconciled to the general ledger.
- . All Personnel Status Change Reports should be prenumbered and controlled to ensure that all required changes are made.

SEMICONDUCTOR DIVISION

- . Intercompany charges should be booked at the Group level.
- . Procedures should be implemented to assign invoice numbers to intercompany sales to Hong Kong.
- . The Company should require timely notification and return of all defective products shipped to Hong Kong.
- . Inventory count sheets should be maintained until the physical inventory compilation is completed.

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COMMODORE BUSINESS MACHINES, INC.

MEMORANDUM ON ACCOUNTING PROCEDURES AND INTERNAL CONTROL

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- . Perpetual records of Hong Kong purchased components on hand should be maintained.
- . Cash accounts should be reconciled and reviewed on a regular basis.
- . Adequate segregation of duties should be implemented in the Expenditures area.
- . Documentation related to purchases and other expenditures should be complete before checks are prepared.
- . The Company should record all transactions on a timely basis and reconcile Accounts Payable detail to the general ledger monthly.

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COMMODORE BUSINESS MACHINES, INC.

SYSTEMS DIVISION

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Situation	Suggestion	Benefits to Commodore	Management Response
<p><u>FINANCIAL REPORTING - EDP</u></p> <p><u>Internal Audit of EDP</u></p> <p>Presently, there is no internal audit of the Data Processing function at Commodore Business Machines, Inc. Without periodic independent verification of the controls in place within the department, there is less assurance that general data processing controls, application controls and system controls are operating effectively.</p>	<p>An EDP Internal Auditor should be hired. His area of responsibility should include review and testing of:</p> <ul style="list-style-type: none"> Controls in functional areas of the EDP Department Systems development activities Applications systems and controls Computer programs and transaction processing, using computer-assisted audit techniques 	<p>An experienced EDP auditor can provide valuable service in reviewing, evaluating and testing data processing controls. Management would have increased assurance that controls are in place and operating effectively to ensure that transactions are being processed correctly and yielding useful results. This will be especially important in the near future as new software applications are being purchased and installed.</p>	<p>There is no reason to believe that controls are not adequate. The current Internal Audit staff can, if it is deemed necessary and cost effective, expand their scope to cover this area.</p>
<p><u>Disaster Recovery Plan</u></p> <p>Presently, the Company has no formally documented disaster recovery plan for its data processing and loss facilities. The destruction and loss of hardware or software could cause significant financial loss as the Company would lose its transaction processing capabilities.</p>	<p>The Company should consider adopting and formally documenting a disaster recovery plan for its data processing facilities. This contingency planning should include "dry" runs to simulate disaster conditions at least once a year.</p>	<p>This type of plan would enable Commodore to continue operating in an efficient manner in the event a disaster were to occur.</p>	<p>An agreement in principle has been reached with another company to provide reciprocal offsite processing capabilities in the event that either company's computers are inoperative. The agreement will be finalized and the communication network completed by March 1985. In addition, we are continuing to look for a System/38 disaster processing service bureau. Once our disaster hardware plans are finalized, we will prepare specific disaster recovery plans and procedures. The plans and procedures should be completed by May 1985.</p>

Our software backup and recovery procedure encompasses copies of files in a fireproof safe at the other end of the building and offsite storage. We believe these plans are adequate.

COMMODORE BUSINESS MACHINES, INC.

SYSTEMS DIVISION

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Situation	Suggestion	Benefits to Commodore	Management Response
<p><u>*Password Security</u></p> <p>The Company utilizes password controls to restrict access to its on-line system. We discussed the use of passwords with certain personnel and noted that in some cases the individuals could access items that they are not normally allowed to access with their password. Additionally, we noted several instances where information was being input using another person's password.</p>	<p>We suggest that EDP management periodically revise passwords to prevent unauthorized access to data files.</p>	<p>The maintenance of password security will provide greater assurance of the integrity of data bases and financial information generated.</p>	<p>We do periodically change passwords. The password(s) are then conveyed to the appropriate users. The control over the password from that point forward is the responsibility of the user(s). We periodically conduct sessions for users on computer terminal operations, and in these sessions we stress the need for control over passwords. We will reemphasize security.</p>
<p><u>Microcomputer Applications</u></p> <p>Most employees individually develop software programs to perform analyses, reconciliations, calculations, etc., using a variety of Commodore computer products. This could result in a duplication of effort. Also, when an employee leaves, there is a risk that no one else may be able to effectively utilize applications developed by the former employee.</p>	<p>The Company should consider establishing an in-house user support group to promote increased communication of internally developed applications between departments. This group should establish policies for documentation of existing applications and act as a clearing house for information.</p>	<p>Increased communication of applications developed may eliminate some duplication of effort and can improve the quality of information throughout the Company. Improved documentation standards will help ensure that programs are correct and usable by all current and future employees.</p>	<p>We have added a programmer to our staff to handle requests for microcomputer programming. We are also in the process of cross-training other programmers in microcomputer applications. Any microcomputer applications developed by Data Processing will be appropriately documented to ensure programmer independence. This capability in Data Processing is not intended to replace the development capability that exists within Commodore for people to efficiently develop specific analyses on Commodore machines using utilities such as VISICALC. To control and monitor all microcomputer applications would not be cost effective.</p>
<p>REVENUE</p> <p><u>Return Authorizations</u></p> <p>Blanket Return Authorizations, which enable customers to return products without specific approval, are in effect for various national accounts. Merchandise returned often does not meet Commodore's criteria for a return (only defective merchandise, not to exceed a specified percentage of net sales). Goods are received which have not been authorized, and large quantities are received which are not defective.</p>	<p>We suggest that a formal policy be developed and implemented regarding refusal of returns on Blanket Return Authorizations.</p>	<p>The Company could realize significant cost savings in the physical processing of goods returned, via only accepting returns in accordance with management's criteria. Additionally, inventory and sales information for defective merchandise will be more reliable.</p>	<p>The Company has formal policies/guidelines. National accounts are important to the Company, and we communicate and correlate our activities closely with these accounts. At times the Company allows returns which may involve exceptions; however, these exceptions are for very solid business reasons and are not made indiscriminately. Returns are in accordance with management criteria; however, the criteria are flexible.</p>

COMMODORE BUSINESS MACHINES, INC.

SYSTEMS DIVISION

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Situation	Suggestion	Benefits to Commodore	Management Response
<p><u>Returns Matching</u></p> <p>The Company currently does not match the majority of returned inventory to the original invoice. This makes it difficult for the Company to estimate its returns experience accurately and also creates a risk that returns may not be credited at the same price for which the items were purchased. This situation could result in interim returns reserve balances being inaccurate. At year-end an adjustment was necessary to increase the reserve.</p>	<p>We suggest that the Company attempt to match returned items to the original invoice in order to calculate a returns timing/experience rate. In some cases, the customer may be able to supply this information.</p>	<p>The Company could more easily calculate a returns experience rate, be certain that interim balances are correct and ensure that credits for returns are not higher than the original sale price.</p>	<p>Returns are analyzed and monitored very closely, and this action coupled with our price protection policy provides adequate control and ensures returned credits do not exceed original sales price. To try to match returns with original invoices would not be cost effective and would not provide additional control over that which exists currently.</p>
<p><u>*Co-op Accrual</u></p> <p>The Company currently accrues for Market Development Funds (MDF) and co-op allowances for financial reporting purposes using a method which is different from that used to determine actual credits granted to customers. As a result, during the year the Company was not fully accrued for co-op allowances and had to "catch-up" during the fourth quarter.</p>	<p>We suggest that the Company adjust its co-op accrual quarterly based upon information supplied by claims processing personnel and that, until the calculation can be fully automated, a thorough review be made on a timely basis to insure the accuracy of the calculation.</p>	<p>Suggested procedures would provide increased control over co-op and MDF advertising funds and provide greater assurance that liability and expense accounts are properly stated.</p>	<p>We accrue for this expense based upon the actual method for granting the credit. Yearend adjustments were necessary because customer allowances were increased during the fourth quarter and not because of the accrual technique.</p>
<p><u>Overpayments of Co-op Allowances</u></p> <p>We noted that on an interim basis there were several large "credit" co-op balances for customers. This indicates an overpayment of co-op claims and could result in an understatement of expenses and liabilities.</p>	<p>We suggest that the Company review the co-op detail on a monthly basis to ensure that all expenses are properly recognized and follow up to ensure these credits are properly authorized.</p>	<p>This review would provide assurance that the liability and expense accounts relating to co-op and MDF are properly stated on an interim basis.</p>	<p>As most customers take only 85% of co-op offered to them, on those occasions that we do grant additional co-op to selected customers the overall net effect is minimal. We do review co-op detail to ensure major discrepancies do not exist.</p>

COMMODORE BUSINESS MACHINES, INC.

SYSTEMS DIVISION

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Situation	Suggestion	Benefits to Commodore	Management Response
<u>High Volume/Past Due Accounts</u> During our review of Accounts Receivable balances, we noted that several very large national accounts had balances past due greater than one million dollars. While these past due amounts do not necessarily represent bad debts, there is a risk that these amounts may not be collectible as they relate to disputes, returns for which no credits have been issued, errors, etc. The Company has made improvements in the area of reconciling these accounts during the past year.	The Company should continue to improve its timely reconciliation of past due, high transaction volume accounts, including adopting a policy for confirming and reconciling accounts on a rotating basis.	The Company could realize receivables on a more timely basis, identify problem accounts sooner and reduce the risk of loss from bad debts.	Many of our national accounts take deductions and anticipate allowances which we will grant, and these appear to be past due accounts. However, the majority of the accounts are reconciled on a timely basis, and our Special Accounting Group within the Credit and Collection Department was established for this purpose. Its achievements in reconciling high volume accounts to date are highly commendable and documented.
CONVERSION	<u>Analysis of Physical Inventory Adjustments</u>	We suggest that the Company continue to emphasize the importance of identifying book-to-physical differences on a timely basis.	Increased use of cycle counts on a daily basis has been implemented. Also, further inventory account detail has been added on the general ledger to isolate problem areas more quickly and to follow up more efficiently. A computerized central inventory control system has been designed with installation scheduled for January 1, 1985. This will strengthen controls over perpetuals and improve audit trails necessary for reconciliations. Quicker identification of adjustments will allow proper interim reserves to be maintained.

COMMODORE BUSINESS MACHINES, INC.

SYSTEMS DIVISION

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Situation	Suggestion	Benefits to Commodore	Management Response
<p><u>Intrawarehouse Inventory Movement</u></p> <p>While significant improvements have been made in controlling inventory movements in and out of the West Chester facility, there is still a need for the Company to increase its monitoring of intrawarehouse transfers including proper cutoff procedures in accounting for the movement of inventory.</p>	<p>The Company should continue to strengthen its inventory control procedures by implementing controls over intrawarehouse transfers sufficient to ensure accurate accounting for inventory movement, including internal shipping and receiving logs, counting of inventory shipped and received from/to other areas and reconciliation of differences between goods shipped from one section of the warehouse and those received in other sections.</p>	<p>Book-to-physical differences could be more easily identified and evaluated by company personnel, and increased control over inventory levels could be achieved.</p>	<p>Steps taken to improve the analysis of physical adjustments will also be keys to this problem. Most areas already have internal shipping (or inventory transfer) and receiving logs. Increased attention will be given to these now that the more important movements in and out of the building are under control.</p>
<p><u>TREASURY</u></p> <p><u>Cash Account Reconciliations</u></p> <p>During our testing of cash balances and review of the related reconciliations, we noted the following:</p> <ul style="list-style-type: none"> • there seems to be a large number of accounts, some of which are not used extensively by the Company. • former employees were still listed as authorized signatures on some accounts. • several accounts contained reconciling items outstanding for over a year, had voided checks which were never added back to the cash balances, had unrecorded disbursements, and were not reconciled during the year. Several adjustments in excess of \$100,000 each were needed at yearend to properly state cash balances. 	<p>We suggest that the Company adopt the following procedures to ensure that important cash management/control techniques are in place and operating effectively:</p> <ul style="list-style-type: none"> • Review the number and usefulness of open accounts; • Review and update authorized signatures frequently; • Prepare reconciliations for all cash accounts on a monthly basis and ensure that adjustments are made as necessary for long-outstanding reconciling items. 	<p>The Company would have accurate cash balances, and the risk of errors or irregularities would be reduced.</p>	<p>Although many accounts have been closed, we agree that a review of the open accounts is necessary. Former employees have been deleted as authorized signatures.</p>

COMMODORE BUSINESS MACHINES, INC.

SYSTEMS DIVISION

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<u>Situation</u>	<u>Suggestion</u>	<u>Benefits to Commodore</u>	<u>Management Response</u>
<u>EXPENDITURE</u>			
<u>Procedures Manual</u>			
The Company does not maintain a formal policies and procedures manual for Accounts Payable or payroll processing.	A formal procedures manual should be developed, which includes actual processing procedures, control techniques and procedures for subsequent review of reports generated.	The existence of such a manual would provide greater assurance that all individuals are aware of and are executing their duties in accordance with management's criteria. Such a manual would also be useful in the case of employee turnover.	Policies and procedures are being developed with the payroll system conversion.
<u>Accounts Payable Items</u>			
During our review of the Company's Accounts Payable reconciliation, we noted that several payables brought over from the old Honeywell System remain as reconciling items. Also, there were several large debit balances totaling \$361,000 which were classified in payables (causing that balance to be understated) and which were determined to be uncollectible and had to be written off.	The Company should review long-outstanding unpaid items to ensure that they represent proper liabilities of the Company. Also, debit balances should be reclassified as receivables when material and their realizability evaluated on a timely basis.	The Company would be certain that payables balances are properly stated in the financial statements.	We agree with the recommendation that reviews should be made regularly to ensure proper account classification and realizability. This procedure is in effect.
<u>PAYROLL</u>			
<u>Control Over Payroll Checks</u>			
The Company does not maintain a control log of payroll check numbers issued by the outside payroll service.	The Company should maintain a control log of all check numbers issued, including subsequent verification against checks prepared.	Suggested procedure will provide assurance that all and only those payroll checks authorized to be prepared are in fact prepared.	The recommendation has been implemented.
<u>Unclaimed Payroll Checks</u>			
Unclaimed employee payroll checks are returned to the Personnel Department (the originator of new employees) and mailed to the individual.	All unclaimed payroll checks should be forwarded to Internal Audit for control and review, as that department has no other payroll processing responsibilities.	By controlling unclaimed payroll checks, the Company can ensure that they represent payments to actual employees for services actually rendered.	Our Internal Audit Department disagrees with the recommendation. Our new procedure has Personnel holding unclaimed checks for 60 days. After this period the checks are returned to General Accounting together with a summary listing, a copy of which is forwarded to the Internal Audit Department.

COMMODORE BUSINESS MACHINES, INC.

SYSTEMS DIVISION

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Situation	Suggestion	Benefits to Commodore	Management Response
<u>Reconciliation Of Payroll Expense</u> The Company does not perform a formal reconciliation of payroll summaries to the General Ledger Interface (source of monthly journal entry).	 The Company should maintain a monthly and year-to-date summary of payroll registers, which should be reconciled to the General Ledger Interface and related expense amounts on a regular basis.	 Suggested procedure would provide assurance that all and only expenditures representing payroll expense are reported as such in the financial statements.	 The monthly payroll summaries are reconciled to the biweekly detail. The payroll interface (the source is the monthly summary) is reviewed by the Accounting Supervisor for reasonableness (i.e., cash disbursement amount, other balance sheet and expense accounts are reviewed). Departmental budget reporting is reviewed in highlighting large variances in salaries expense. Also, on a monthly basis, all payroll-related balance sheet accounts in the general ledger are analyzed and reconciled to the detail, thus reducing any possibility of payroll inaccuracies in the general ledger.
<u>Changes To Payroll Masterfile</u> Personnel Status Change Reports (PSCs) prepared by Personnel and submitted as input for changes to the employee masterfile are not prenumbered and controlled. There have been many instances of changes submitted, but never processed, resulting in incorrect amounts being paid to employees.	 PSCs should be prepared in duplicate and prenumbered, with a control log maintained of PSCs submitted for processing. The Personnel Department should ensure that all changes are made on a timely basis via review of was-is reports and subsequent payroll registers.	 Suggested procedures would ensure that all changes submitted are actually made, resulting in payment of proper amounts to all employees.	 We agree, and the recommendation has been implemented.

COMMODORE BUSINESS MACHINES, INC.

SEMICONDUCTOR DIVISION

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Situation	Suggestion	Benefits to Commodore	Management Response
<p><u>INTRODUCTION</u></p> <p>Growth in 1984, especially related to raw material component purchases on behalf of Hong Kong, exceeded the ability of division personnel at the Group level to record transactions timely and accurately. As a result, internal accounting controls at Group were generally weak, and accounting records and documentation were incomplete and disorganized. Current efforts to improve controls and upgrade number and quality of personnel should be continued. The following items should be addressed as part of this process.</p>			<p>We have made improvements in our efforts to establish financial controls through additional staffing, better training and upgrading of positions.</p>
<p><u>FINANCIAL REPORTING</u></p> <p><u>Intercompany Transaction Recording</u></p> <p>All intercompany charges are recorded initially on the Group's general ledger. The charges are passed on via the issuance of debit notes to Norristown or Costa Mesa, as appropriate, to be booked to their separate general ledgers. Norristown and Costa Mesa have not been properly booking these charges, and as a result, at June 30, 1984, Semiconductor has an intercompany balance with itself of \$122,000.</p>	<p>Intercompany charges should be booked directly to the Norristown and Costa Mesa general ledgers by Semiconductor Group Accounting personnel.</p>	<p>This procedure would provide greater assurance that all intercompany charges are properly booked and that no amounts remain in "suspense."</p>	<p>Any transactions not booked by Norristown and Costa Mesa are now being booked by the Group directly to ensure that the Semiconductor intercompany account is always in balance.</p>

COMMODORE BUSINESS MACHINES, INC.

SEMICONDUCTOR DIVISION

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<u>Situation</u>	<u>Suggestion</u>	<u>Benefits to Commodore</u>	<u>Management Response</u>
<u>Invoice Preparation</u> A numerical sequence of invoice numbers for die shipments to Hong Kong is not adequately maintained at Costa Mesa. Also, invoices for different shipments have been assigned the same number on several occasions.	 We suggest that the Company implement and maintain procedures for the assignment of invoice numbers for sales of semiconductor products to Hong Kong and the subsequent verification thereof.	 Accurately prepared, numerically sequenced invoices to Hong Kong will aid in preventing errors or duplicate entries which could result in differences in the intercompany accounts.	 In a few instances, Costa Mesa has used duplicate invoice numbers in invoicing CEL. This has not resulted in any duplicate transactions being booked; however, Costa Mesa accounting personnel have been advised of the problem. Future plan is to have all invoicing done by the Group.
<u>Defective Intercompany Shipments</u> Hong Kong does not return devices purchased by Semiconductor from outside vendors which are found to be defective on a timely basis; however it does charge back Semiconductor for the invoiced amount of the defective goods. Semiconductor is still liable to the vendor for the full purchase price as the vendors will not give credits unless the goods in question are returned on a timely basis and with the appropriate documentation.	 Semiconductor should require timely notification and return of all devices purchased from outside vendors which are found to be defective.	 Semiconductor can return the defective goods to the original vendor and obtain the appropriate credits, thereby reducing total cost of purchased components.	 In order for the Group to return defective goods to the original vendor, the following conditions must be adhered to: <ul style="list-style-type: none">• The goods must be returned to the USA on a timely basis.• The group needs time to secure an RMA # from the vendor.• Defective parts must be identified against a particular group invoice to CEL.• Limits have been established as to quantity/dollars to be reached before goods are returned. The cost of maintaining the above should be weighed against the value of the goods to be returned. Industry acceptance levels of defective goods range from 1% to 2% of units shipped.

COMMODORE BUSINESS MACHINES, INC.

SEMICONDUCTOR DIVISION

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<u>Situation</u>	<u>Suggestion</u>	<u>Benefits to Commodore</u>	<u>Management Response</u>
CONVERSION			
<u>Costa Mesa Inventory Compilation</u>			
The May 1984 physical inventory at Costa Mesa was taken via count sheets which were not retained after the perpetual inventory records were adjusted.	All count sheets (or copies thereof) should be maintained for future reference.	If any unusual items or discrepancies arise during the inventory compilation, the count sheets may be a valuable tool in locating errors.	The physical inventory records for Costa Mesa were not retained. The local Arthur Andersen & Co. auditor in California has the original. We will see that a copy is made from the original and retained. Inventory tags must be made from lint-free paper in order to be used in a clean room environment. Since they were not available, a computer printout was used for the inventory taking. In the future, lint-free inventory tags will be used quarterly for the physical inventory.
<u>Perpetual Records of Hong Kong Purchases</u>			
Perpetual records of components purchased from outside vendors for resale to Hong Kong have not been maintained to date. At June 30, 1984, this inventory totaled \$3 million, which is approximately one-third of total Semiconductor inventory.	A perpetual record of such components on hand should be maintained and reconciled to the book balance periodically.	The suggested procedure would provide greater assurance that inventory balances per the financial statements represent actual goods on hand or in transit.	The physical quantity of Hong Kong purchases on hand is usually small. Most of the inventory is in an in-transit stage, either to the freight forwarder or to Hong Kong. We control incoming purchases and outgoing shipments with our own master control log. Each invoice for incoming purchased material is logged into the control sheet. All shipments, (controlled by shipping documents and AWB) are posted to the control sheet. The control sheet is analyzed to determine which received items were not shipped. This represents a perpetual inventory.
TREASURY			
<u>Bank Reconciliations</u>			
Cash accounts are not reconciled on a regular basis; as of September 20, 1984, the June 30 reconciliation had not yet been completed. As a result, cash balances per the financial statements may not properly represent the Company's cash on hand.	All cash accounts should be reconciled monthly by an individual independent of the cash disbursements function. These reconciliations should be reviewed by management on a timely basis.	Timely bank reconciliations would validate cash balances and would reveal any errors or irregularities in the cash disbursements function. This is a critical function in light of the volume of purchasing for Hong Kong.	We have set up a program to ensure that all bank accounts are reconciled on a monthly basis. The June 1984 statements for MHT accounts are lost. Duplications have been requested but not received. For the moment, we are working around the missing statements and will finalize the reconciliations as soon as they are received.

COMMODORE BUSINESS MACHINES, INC.

SEMICONDUCTOR DIVISION

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Situation	Suggestion	Benefits to Commodore	Management Response
EXPENDITURE			
<u>Segregation Of Duties</u>			
One individual is responsible for virtually all Accounts Payable functions, from the vouchering of invoices to the preparation and mailing of checks and subsequent "reconciliation" of cash accounts. Additionally, anyone with access to the Accounts Payable system also has access to the general ledger system.	The Company should implement an adequate segregation of duties including the separation of the bank reconciliation and cash disbursement functions. Individuals inputting accounts payable information should have access to only the necessary data.	An adequate segregation of duties, in conjunction with restricted access to systems, would lessen the likelihood of errors or irregularities in the cash disbursements area.	With the increase in staffing, segregation of duties has been accomplished. Accounts Payable personnel do not have access to general ledger functions and vice versa. Bank reconciliations are outside the realm of the Accounts Payable department.
<u>"Holding" Prepared Checks</u>			
Checks for capital expenditures are prepared prior to the actual acceptance of equipment and are often held by the Company for a number of weeks, awaiting various approvals, resulting in misstated cash and property or expense balances.	All necessary approvals should be obtained on check requests and invoices prior to the preparation of a check. All checks prepared should be sent to the payee on a timely basis.	The bank reconciliation process will be simplified, and the cash and property balances will be properly stated.	All held checks are put back into the cash pool on a quarterly basis to properly reflect cash balances. On occasion, a check is held pending receipt of a capital equipment acceptance form. Manual checks which are held are booked into the systems to reflect the A/P liability. On capital equipment the invoice is booked into the system upon receipt. At the same time, an acceptance form is sent to the requestor. The equipment must be up and running to specifications before it is accepted, which usually takes four to six weeks time. The computer generates a check which is then matched to the acceptance by the fixed asset clerk. The check is held if the equipment is not accepted. The fixed asset clerk then pursues the acceptance.
<u>Accounts Payable</u>			
The Accounts Payable Trial Balance is not reconciled to the general ledger on a timely basis. Additionally, except for inventory items, there are no procedures to accrue for invoices not vouchered at month end.	We suggest that the Company adopt formal accounts payable procedures to include the accrual of all significant unvouchered invoices at month end and a reconciliation of the Accounts Payable Trial Balance to the general ledger on a regular basis.	These procedures will provide greater assurance that the Accounts Payable balance properly reflects all liabilities of the Company at a point in time.	The accounts payable open item report is now reconciled monthly to the general ledger. Hong Kong purchases are vouchered from manual checks. This is done because of the need to write checks almost on a daily basis, and items not paid are accrued at month end.

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